

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MUHLENBERG COUNTY)
WATER DISTRICT NO. 3 FOR RATE) CASE NO. 2012-000017
ADJUSTMENT FOR SMALL UTILITIES)
PURSUANT TO 807 KAR 5:076)

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of February 23, 2012, the attached report containing the findings and recommendations of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding.



Jeff Derksen
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED: MAR 30 2012

cc: Parties of Record

STAFF REPORT
ON
MUHLENBERG COUNTY WATER DISTRICT NO. 3
CASE NO. 2012-00017

On January 24, 2012, Muhlenberg County Water District No. 3 ("Muhlenberg County") applied to the Commission pursuant to 807 KAR 5:076 to adjust its rates for water service. Based on historical test-year operations for the calendar year ending December 31, 2010, adjusted for known and measureable changes, Muhlenberg County proposed rates that will produce additional annual revenue from water sales of \$118,114, an increase of 12.97 percent over normalized water sales revenue of \$910,826. The proposed adjustment would increase the monthly bill of a customer who uses 5,000 gallons of water from \$25.04 to \$28.29, an increase of 12.98 percent.

Commission Staff members Daryl Parks and Eddie Beavers performed a limited financial review of Muhlenberg County's test-year operations to determine whether test-period operating revenues and expenses are representative of normal operations and the proposed adjustments are reasonable.¹ They did not pursue and have not addressed in this report insignificant or immaterial discrepancies. Where they have not expressly addressed a test-period expense, they found insufficient evidence to contest the reasonableness of that expense.

This report summarizes Staff's review and recommendations. Mr. Beavers reviewed Muhlenberg County's operating revenue calculations, its calculation of the proposed rates, and its proposed rate design. Mr. Parks addressed all pro forma

¹ Mr. Parks and Mr. Beavers inspected Muhlenberg County's records while assisting Muhlenberg County in the preparation of its rate application.

expense adjustments and the revenue requirement determination. Commission Staff's recommended pro forma operating statement is set forth in Appendix A. At Appendix B, Commission Staff sets forth its findings and recommendations regarding Muhlenberg County's test-period operations. Commission Staff's calculation of Muhlenberg's revenue requirements is shown at Appendix C. Commission Staff's recommended rates are found at Appendix D.

Commission Staff finds that Muhlenberg County's application accurately reports its test-period operations and that its proposed pro forma adjustments generally meet the ratemaking criteria of known and measurable. Commission Staff, however, proposes adjustments to Muhlenberg County's Salaries and Wages Expense and its Purchased Power Expense. Commission Staff finds that Muhlenberg County's pro forma Utility Operating expenses are \$920,224.

The Commission has historically used the Debt Service Coverage ("DSC") methodology to determine the revenue requirement for water districts. This approach is used primarily because a bond ordinance or loan agreement requires the water district or association to maintain a predetermined DSC level. Commission Staff, however, does not recommend the use of this methodology in this case because Muhlenberg County has no outstanding long-term debt.

Muhlenberg County proposes the use of the operating ratio methodology to calculate its revenue requirement. Commission Staff concurs with this proposal. The operating ratio methodology is used when there is no basis for a rate-of-return determination, the cost of the utility has fully or largely been funded through contributions, or there is little or no outstanding long-term debt. Commission Staff is of

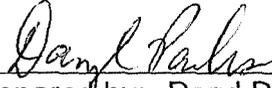
the opinion that an operating ratio of 88 percent will allow Muhlenberg County sufficient revenues to cover its reasonable operating expenses and provide for reasonable equity growth.

As shown in Appendix C, applying an 88 percent operating ratio to the recommended pro forma Utility Operating Expenses of \$920,224 produces a revenue requirement from rates of \$1,009,164. This revenue requirement requires an increase of \$98,338, or 10.80 percent, above Muhlenberg County's normalized revenue from rates of \$910,826.

Neither Muhlenberg County nor Commission Staff performed a cost-of-service study in this case. Commission Staff agrees with Muhlenberg's proposal that each rate block within the current rates be increased by an equal percentage derived from the percentage increase in revenue requirement over adjusted test-period revenues. The Commission has previously found this approach to be acceptable. Applying this approach, Commission Staff has developed the rates set forth in Appendix D, which reflect an approximate 10.80 percent increase to each rate block of Muhlenberg's current rates and which will generate annual revenue from rates of \$1,009,164. Approval of these rates would increase the monthly bill of a customer who uses 5,000 gallons of water from \$25.04 to \$27.75, or 10.82 percent.

In summary, Commission Staff finds that Muhlenberg County's proposed rates will generate revenues in excess of \$1,009,164 and recommends that those rates be denied. It further recommends that the rates set forth in Appendix D be approved for service that Muhlenberg County renders.

Signatures



Prepared by: Daryl Parks
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis



Prepared by: Eddie Beavers
Rate Analyst, Communications, Water and
Sewer Rate Design Branch
Division of Financial Analysis

APPENDIX A
STAFF REPORT, CASE NO. 2012-00017
ADJUSTED OPERATING STATEMENT

	Test year	Adjustment	Ref.	Pro Forma
Operating Revenues				
Water Sales	\$ 865,141	\$ 45,685	A	\$ 910,826
Other Operating Revenues	24,696			24,696
	<hr/>			<hr/>
Operating Revenues	889,837	45,685		935,522
	<hr/>			<hr/>
Operating Expenses				
Operation and Maintenance				
Salaries and Wages - Employees	196,825	13,978	B	210,803
Salaries and Wages - Commissioners	18,000			18,000
Employee Pension & Benefits	78,252			78,252
Purchased Water	420,965	(20,606)	C	400,359
Purchased Power	20,797	(879)	D	19,918
Fuel for Power Production	4,115			4,115
Materials and Supplies	29,614			29,614
Contractual Services - Accounting	6,000			6,000
Contractual Services - Legal	75			75
Contractual Services - Water Testing	13,285			13,285
Transportation	11,037			11,037
Insurance - Vehicle/General Liability	9,642	519	E	10,161
Insurance - Workers Compensation	4,962	382	F	5,344
Insurance - Other	102	12	G	114
Advertising	2,023			2,023
Bad Debt Expense	2,392			2,392
Miscellaneous	12,464			12,464
	<hr/>			<hr/>
Total Operation and Maintenance Expenses	830,550	(6,594)		823,856
Depreciation	81,074	(2,105)	H	78,969
Taxes Other Than Income				
Payroll Taxes	16,282	1,221	I	17,503
PSC Assessment	1,372			1,372
Utility Operating Expenses	929,276	(7,478)		921,700
Operating Income	<hr/>	<hr/>		<hr/>
	\$ (39,441)	\$ 53,163		\$ 13,822
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APPENDIX B
STAFF REPORT, CASE NO. 2012-00017
EXPLANATION OF ADJUSTMENTS

(A) Water Sales. Test-year water sales were stated at \$865,141. After performing an analysis of test-year usage for all customers, Muhlenberg County determined revenues should have been reported at \$910,826. Accordingly, test-year revenues were increased by \$45,685. The billing analysis is included in Muhlenberg County's application at page 27. Staff agrees with this adjustment and recommends it be accepted by the Commission.

(B) Salaries and Wages – Employees and Commissioners. In its application, Muhlenberg County proposed to increase test-year salaries by \$31,978 based on current pay rates of all current employees and officers. In its proposed adjustment, Muhlenberg County first determined total pro forma salaries to be paid to employees and officers. Then, test-year salaries for only employees were subtracted from the pro forma expense. Test-year salaries for officers were not subtracted. This error results in an overstatement of the pro forma expense by \$18,000. Staff calculated the correct increase to be \$13,978 as shown below.

Employee	Pro forma Salaries
1	\$ 6,000
2	6,000
3	6,000
4	44,690
5	33,876
6	36,679
7	13,271
8	34,718
9	31,450
10	<u>16,120</u>
Pro forma	228,804
Less: Test year	<u>(214,825)</u>
Increase	<u>\$ 13,979</u>

(C) Purchased Water. In its application, Muhlenberg County determined that its water loss percentage during the test year was 19.225 percent. 807 KAR 5:066, Section 6(3), states that, "for rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations." Accordingly, Muhlenberg County proposed to reduce its purchased water expense by \$20,605. Staff agrees with this adjustment and recommends it be accepted by the Commission. The calculations are shown on the next page.

Pro forma Gallons Sold (000 omitted)	215,935.2
Add: Flushing and Fire Department Use	<u>820</u>
Total Gallons Sold and Used	216,755.2
Gross-up for 15 Percent Allowable Water Loss	<u>0.85</u>
Allowable Gallons to be Purchased	255,006.118
Times: Current Purchase Price per 1,000 gallons	<u>\$ 1.57</u>
Cost of Allowable Purchases	400,360
Less: Test year	<u>(420,965)</u>
Decrease	<u>\$ (20,605)</u>

(D) Purchased Power. As previously discussed, Muhlenberg County's calculated water loss is 19.225 percent, 4.225 percent above that allowed by 807 KAR 5:066, Section 6(3). Traditionally, the Commission removes the cost of water purchases over the allowable limit from revenue requirements, as well as the cost of fuel for power to pump this water. While Muhlenberg County proposed to remove the cost of the excess water loss, it did not remove the cost to pump this water. Following traditional ratemaking methods of the Commission, Staff reduced test-year purchased power costs to remove the cost to pump the excess water loss. The adjustment is shown below.

Purchased Power expense	\$ 20,797
Water Loss in Excess of 15%	<u>4.225%</u>
Decrease:	<u>\$ 879</u>

(E) Insurance – General Liability/Vehicle. For the test year, Muhlenberg County's general liability premium was \$9,642. The current premium expense is \$10,161, an increase of \$519 over the test year.

(F) Insurance – Workers Compensation. For the test year, Muhlenberg County's workers compensation premium was \$4,962. The current premium expense is \$5,344, an increase of \$382 over the test year.

(G) Insurance – Other. For the test year, Muhlenberg County's Encroachment Bond premium was \$102. The current premium expense is \$114, an increase of \$12 over the test year.

(H) Depreciation. During the test year, Muhlenberg County reported depreciation expense of \$81,074. It proposed to decrease this amount by \$2,105 to account for: 1) a full year of depreciation for items capitalized in 2010; 2) changes to the depreciable lives of certain assets; and 3) items fully depreciated in the test year. The calculation of the adjustment is shown on the next page.

	Test Period			Depreciation		
	Dep	Exp	Cost	Life	Expense	Adjustment
(1) Normalized Depreciation (Full Year)						
High Pressure Switch	\$	4	\$ 869	40	\$ 22	\$ 18
Transmission & Dist Mains		28	3,658	65	56	28
Meters & Installation		300	23,993	40	600	300
Radio Read Meters		1,229	98,318	40	2,458	1,229
Radio Read Cover Kits		573	45,870	40	1,147	574
1" Radio Read Meters		29	1,960	40	49	20
Radio Read Meters		12	5,772	40	144	132
Crosscut Shredder		31	160	3	53	22
HP Computer		8	495	5	99	91
3 Telephones		6	385	5	77	71
Computer Monitor		-	206	5	41	41
Coffee Maker		-	100	3	33	33
Impact Wrench		12	299	10	30	18
5 Generators/Installation		397	95,176	40	2,379	1,982
(2) Depreciable Lives Changed						
Three A/C Units - Pumpstations		90	897	20	45	(45)
Tapping Valve		118	1,182.84	20	59	(59)
Tank 1 Refurbished		5,125	102,495	40	2,562	(2,563)
Tank 2 Refurbished		5,174	103,480	40	2,587	(2,587)
Roof - Office Building		228	2,734	40	68	(160)
Roof - Office Building		235	4,700	40	118	(117)
Trash Pump		53	190	10	19	(34)
Water Pump		97	389	10	39	(58)
Rebuilt Pump		143	5,731	20	287	144
Rebuilt Pump		169	6,764	20	338	169
Pump Motor		14	861	20	43	29
Additional Tank Refurb		76	4,560	40	114	38
Radio Read Comp Software		2,042	17,500	10	1,750	(292)
Gas Line - Pump Station		3	900	40	23	20
20' Aluminum Ext Ladder		21	125	10	12	(9)
Garmin GPS		6	342	10	34	28
(3) Items Fully Depreciated in Test-Period						
Booster Station Pumps		40	802	10		(40)
HP 1040 Inkjet Fax Machine		12	100	5		(12)
3" Trash Pump		20	300	5		(20)
2" Pump		22	263	5		(22)
Kubota Tractor		1,074	21,480	10		(1,074)
Pro Forma Adjustment						<u>\$ (2,105)</u>

(I) Payroll Taxes. Payroll taxes will increase by \$1,221 as a result of the increase to test-year salaries and wages expense discussed in Item B. Test-year payroll tax expense was increased by this amount. The calculation is shown on the next page.

Pro Forma Payroll, See Item A	\$ 228,603
Times FICA Rate	<u>7.65%</u>
Pro Forma FICA Taxes	17,503
Less: Test Year	<u>(16,282)</u>
Increase:	<u>\$ 1,221</u>

APPENDIX C
STAFF REPORT, CASE NO. 2012-00017
REVENUE REQUIREMENT CALCULATION

Net Pro Forma Operating Expenses	\$ 921,700
Divided by: Operating Ratio	<u>88%</u>
Subtotal	1,047,387
Add: Interest Expense	<u>77</u>
Total Revenue Requirement	1,047,464
Less: Other Income and Deductions	(13,604)
Other Operating Revenue	<u>(24,696)</u>
Revenue Requirement	1,009,164
Less: Pro Forma Revenue	<u>(910,826)</u>
Requested Increase	<u>\$ 98,338</u>
Percentage Increase	<u>10.797%</u>

APPENDIX D
STAFF REPORT, CASE NO. 2012-00017
STAFF'S RECOMMENDED RATES

First	2,000	gallons	\$ 15.21 Minimum Bill
Next	8,000	gallons	4.18 per 1,000 gallons
Next	10,000	gallons	3.89 per 1,000 gallons
Next	30,000	gallons	3.52 per 1,000 gallons
Over	50,000	gallons	3.24 per 1,000 gallons

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